To Our Clients

Recent Developments

1. Extraterritorial Application of the Federal Securities Laws. Judge Friendly's opinion in Bersch v. Drexel Firestone, Inc., [Current] CCH Fed. Sec. L. Rep. ¶ 95,080 (2d Cir. 1975) succintly summarizes the law:

> "We have thus concluded that the anti-fraud provisions of the federal securities laws:
>
> (1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and
>
> (2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but
>
> (3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses."

This was amplified in the companion opinion in IIT v. Vencap, Ltd., [Current] CCH Fed. Sec. L. Rep. ¶ 95,082 (2d Cir. 1975):

> "We do not think Congress intended to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners. This country would surely look askance if one of our neighbors stood by silently and permitted misrepresented securities to be poured into the United States. By the same token it is hard to believe Congress meant to prohibit the SEC from policing similar activities within this country; we doubt that the result in SEC v. United Financial Group, Inc., 474 F. 2d 354, 357 (9 Cir. 1973), would

> have differed if the court had not been able to find that the issuer was an American corporation and that three American investors held $10,000 of its probably worthless stock. If there would be subject matter jurisdiction over a suit by the SEC to prevent the concoction of securities frauds in the United States for export, there would also seem to be jurisdiction over a suit for damages or rescission by a defrauded foreign individual. Our ruling on this basis of jurisdiction is limited to the perpetration of fraudulent acts themselves and does not extend to mere preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries, such as in Bersch. Admittedly the distinction is a fine one. But the position we are taking here itself extends the application of the securities laws to transnational transactions beyond prior decisions and the line has to be drawn somewhere if the securities laws are not to apply in every instance where something has happened in the United States, however large the gap between the something and a consummated fraud and however negligible the effect in the United States or on its citizens."

2. Rule 10b-5; "Corporate Mismanagement Exception". Judge Friendly's opinion in the IIT case indicates a belief that the Supreme Court in the Superintendent of Insurance case struck the deathknell of the "corporate mismanagement exception."

3. Definition of Security; Notes; Commercial-Investment Test. Judge Friendly's opinion in the IIT case also indicates acceptance of the commercial-investment test to determine whether a note is a "security" within the federal securities laws -- and, indeed, Judge Friendly indicates a rather narrow approach to treating notes issued in private transactions as "securities".

4. Tender Offers. The decision in Jewelcor, Inc. v. Lafayette Radio Electronics Corp., S.D.N.Y. 75 Civ. 537, May 6, 1975 contains a number of interesting holdings as to interpretation and application of the Williams Act (As is typical in this area the decision is largely procedural and the holdings relate primarily to assumed facts.):

(a) Schedule 13D does not require disclosure of merger discussions between the acquiror and the target absent any purpose of the acquiror to obtain control of the target.

(b) Schedule 13D does not require disclosure that the acquiror holds the securities of the target in nominee name.

(c) In a situation where the acquiror has purchased for investment and to strengthen its position in anticipation of merger discussions, it is sufficient that the 13D state the purpose as "investment" if it also discloses that merger has been or will be considered. The Court said:

> Lafayette's primary contention is that while [Item 4] of Schedule 13D calls for disclosure of the purchaser's plans and purposes, Jewelcor has failed to describe accurately its purposes. Jewelcor's purposes, according to Lafayette, were investment <u>and</u> strengthening its position in anticipation of discussions regarding a business combination with Lafayette. According to Lafayette, Jewelcor's Schedule 13D was inaccurate since it stated that it was buying Lafayette stock 'for purposes of investment.' Jewelcor contends that its Schedule 13D must be viewed as a whole, without isolating its statement that it bought Lafayette stock for investment purposes. We agree with Jewelcor. It seems to us that Lafayette is making too much of the distinction between plans and purposes, especially since both subjects must be discussed in the same item of Schedule 13D. Schedule 13D requires a statement of the plans of the purchaser if and only if one of the purposes of the purchase is 'to acquire control of the business of the issuer.' Thus, Jewelcor's statement that it has considered possible business combinations with Lafayette necessarily implied that one of the reasons it had bought Lafayette stock was the formation of some kind of business combination with Lafayette.

> . . . . Moreover, Jewelcor might well have been guilty of violating §13(d) had it specifically stated that one of its purposes for purchasing Lafayette stock was furthering Jewelcor's interest in merging with Lafayette, if such option were in fact only a possibility."

(d) Where the primary purpose of an acquiror is to frustrate a takeover by a third party that must be specifically disclosed -- citing Loews Corp. v. Accident & Cas. Ins. Co.

(e) Where the acquiror has made substantial working capital borrowings, even though not earmarked for the purchase of shares of the target, such borrowing should be disclosed as related to the acquisition of the shares of the target.

(f) Management acting in concert to defeat a possible tender offer can be a "group" required to file under §13(d). The Court said:

> "The two cases on which Lafayette relies for support of its proposition that management groups need not file Schedule 13D statements both concerned groups consisting only of a company's officers and directors. See Corenco Corp. v. Schiavone & Sons, Inc., 488 F.2d 207, 218 (2d Cir. 1973); Scott v. Multi-Amp Corp., 386 F. Supp. 44, 61-63 (D.N.J. 1974). Here, by contrast, the alleged group involves nonmanagement entities such as the Estate of Abraham Pletman, Lafayette's largest stockholder. If a group including Lafayette management and the Pletman estate did in fact exist, it certainly would have been required to file a Schedule 13D, since §13(d) disclosure is designed to keep the investing public informed about potential changes in corporate management and control and able to evaluate adequately a company's worth. GAF Corp. v. Milstein, 453 F.2d 709 (2d Cir. 1971), cert. denied, 406

U.S. 910 (1972). See also Comment Section 13(d) and Disclosure of Corporate Equity Ownership, 119 U.Pa.L.Rev. 853, 854-55, 876 (1971). Or, as another court has stated, §13(d) was intended to apply whenever 'substantial shareholders or management undertake to acquire shares in a corporation for the purpose of solidifying their own position in a contest over how or by whom the corporation should be managed.' Bath Indus., Inc. v. Blot, 427 F.2d 97, 99 (7th Cir. 1970) (emphasis supplied).

Moreover, we do not agree with Lafayette that §13(d) does not apply to management groups. In Corenco Corp. v. Schiavone & Sons, supra, the Second Circuit considered whether §13(d) applies to management groups. In that case, the agressor company in a tender offer contest argued that the management of the target should have filed a Schedule 13D since its members allegedly constituted a management group formed to oppose the tender offer. The Court rejected this argument, finding that 'the members of [the aggressor's] management were not required to file individual Schedule 13D statements when they agreed to pool their interests to fight the threatened takeover.' 488 F.2d at 218. However, that conclusion did not amount to a holding that management groups are never required to file Schedule 13D statements, since the court found that §14(d)(4) of the Exchange Act specifically requires the disclosure of certain information when the management of a company advises its shareholders to reject a tender offer. Id. Here, where there has been no tender offer, we believe that the provisions of §13(d) should apply to management groups, especially management groups including nonmanagement members.

This view has recently been supported by the SEC. Tony Lama Co., CCH Fed. Sec. L. Rep. ¶79,901 (1974). But see Scott v. Multi-Amp Corp., supra, at 61-63 (D.N.J. 1974). We thus find that even if the alleged Lafayette directors' group were to consist only of management personnel, that group still would have been required to file a Schedule 13D."

M. Lipton